Oregon Center for Public Policy

Executive Summary

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March 17, 2003

The Capital Gains Bird Does Not Fly:
The Unmoving Case of Tax Cut Advocates

By Jeff Thompson

Opponents of Oregon's tax on capital gains income argue that many households move out of state, particularly to Clark County, Washington, to avoid paying the tax. These claims are overstated. The number of taxpayers with capital gains income moving to Clark County is quite small. Movement to Clark County is also largely offset by movement from Clark County to Oregon. Most households likely move to Clark County for other reasons than to avoid paying the capital gains tax, primarily housing affordability and school quality.

Analysis of tax and migration data suggests that few, households move to Clark County to avoid the capital gains tax:

- An average of 357 households with any capital gains income moved from Oregon to Clark County each year between 1993 and 2001, representing 0.03 percent of all full-year returns and 0.16 percent of full-year returns with capital gains income;
- Between 1998 and 2000 more than 60 percent of total migration to Clark County was offset by households moving from Clark County to Oregon;
- An average of 16.5 percent of full-year residents had capital gains income between 1993 and 2001, compared to 10 percent of households moving to Clark County, and;
- Most mobile Oregonians move to other Oregon counties, not different states. Those choosing to move to Clark County, Washington, have similar incomes as households that remain in Oregon, providing no evidence that movement to Clark County is an exodus of wealthy Oregonians.

Even if there are households that move to avoid the tax, this does not mean that Oregon loses investment or jobs. The ease of restructuring investments makes it likely that the investments will remain in Oregon even if the owners move to Clark County.

According to the Legislative Revenue Office, reducing the tax from 9 percent to 4 percent would cost $319 million in the 2005-07 budget cycle. Because capital gains income is so highly concentrated among the affluent, most Oregonians would see little or no benefit:

- The richest one-percent of households has 57 percent of capital gains income in Oregon, and the bottom 80 percent have just 13 percent, and;
- More than 80 percent of households have no capital gains income, and the top 0.4 percent of households averaged $524,000 in capital gains income in 2000.

That the richest one percent of households had $3.5 billion in capital gains income in 2000 and remained in Oregon, further suggests that the tax has little impact on migration.

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Several tax bills have been introduced into the Oregon Legislative Assembly that would grant special treatment to income from capital gains, including Senate Bills 91, 361, and 813, and House Bills 2505, 2488, and 2806. Currently capital gains income is taxed at the same rates as all other income.

Advocates for cutting the income tax on capital gains argue that people move from Oregon, particularly to Clark County, Washington, to avoid paying it.[1] The departure of affluent individuals, the argument goes, harms Oregon's economy and drains investment and tax revenues from the state. Sometimes the argument is made with anecdotal evidence; someone knows or heard of someone else who moved to Washington to avoid Oregon's income tax on capital gains. It is characterized as a flood requiring a change in tax policy.

Analysis of tax and migration data finds that advocates' claims are badly overstated. The number of taxpayers

Mass Exodus Myths

"We've certainly seen a lot of people move to Clark County just before they sell their business."

William B. Conerly, Cascade Policy Institute Board Chairman, on the *Lars Larson Show, KXL Radio,* February 8, 2002

"One of Oregon's best known philanthropists, who also controls a major charitable foundation, is giving serious consideration to joining the multitude of others who have made their fortunes in our state and since moved across the river."

Gerry Frank, columnist, *The Oregonian*, April 27, 2001

"This system creates strong incentives for successful Oregonians to relocate out of state when they sell their businesses or exercise accumulated stock options. This costs Oregon tax revenue, and more importantly, the capital and business acumen that these individuals possess."

Oregon Business Council, *The Oregon Agenda POLICY PLAYBOOK, Public Issues and Recommendations for 2001,* January 2001.

with capital gains income moving to Clark County is quite small, representing a tiny share of all taxpayers and of those with capital gains income. It is at best a trickle. The number of households moving to Clark County is also substantially offset by those moving from Clark County to Oregon. Most households moving to Clark County likely do so for reasons other than to avoid paying Oregon's capital gains tax. Even if there are households that move to avoid the tax, this does not mean that Oregon loses investment.

Capital gains represent a considerable portion of Oregon's total income. Reducing taxes on capital gains income would result in a large tax cut. Because capital gains income is so highly concentrated among the affluent, most Oregonians would see little or no benefit.

Moving to Vancouver?

Tax cut advocates argue that people leave the state and move to Clark County, Washington to avoid Oregon's tax on capital gains income. While it is possible that some people move to Washington to avoid the tax, the number leaving is quite small, and their departure likely has no economic impact on Oregon.

The average annual number of households with capital gains income leaving Oregon for Clark County between 1993 and 2001 was 357, or 0.16 percent of all Oregon households with capital gains income in those years (Table 1). Households with capital gains that leave for Clark County were just 0.03 percent of all full-year returns. Put differently, for every ten thousand full-year taxpayers, three taxpayers with capital gains income moved to Clark County. For every ten thousand full-year taxpayers *with capital gains income*, sixteen moved to Clark County.

Table 1. Capital Gains and Migration to Clark County – 1993 to 2001 Annual Average*

	#	% of total returns	% of cap gains returns
Total Full-Year Returns	1,358,012	100%	NA
Returns with Capital Gains	225,719	16.6%	100%
Capital Gains Returns Moving to Clark County, Washington	357	0.03%	0.16%

*2001 figures are preliminary.

Source: OCPP analysis of ODR data.

In 2000, the latest year for which complete data are available, 459 households with capital gains income moved from Oregon to Clark County, just 0.03 percent of all full-year returns and 0.17 percent of full-year returns with capital gains income (See Appendix A for data from all years between 1993 and 2001).

Capital gains income of households moving to Clark County, Washington was equal to just 1.2 percent of the total gains of Oregon full-year residents, on average, between 1993 and 2001.[2]

Between 1993 and 2001, residents with capital gains income moving anywhere outside of Oregon, including Clark County, Washington, were just 0.3 percent of all full-year returns and 1.9 percent of all returns with capital gains income. Since Oregon received considerable in-migration over the last decade, capital gains of those leaving

Oregon will almost certainly be more than offset by the capital gains of households moving to Oregon. Between 1990 and 2000, Oregon's net migration was 421,500 people, accounting for 73 percent of the state's total population growth.[3]

Table 2. Migration between Oregon and Clark County, Washington	
	Annual Average (1998-2000)
In from Clark County	2,474
Out to Clark County	3,953
Net migration to Clark County from Oregon	1,479
% of out-migration offset by in-migration	63%

Source: OCPP analysis of IRS migration data.

In-migration from Clark County

The number of taxpayers with capital gains income that move to Clark County, Washington is quite small, but even these statistics overstate the matter. In recent years more than 60 percent of the migration to Clark County has been offset by migration from Clark County to Oregon. An average of nearly 4,000 households, including those with and without capital gains income, annually have moved from Oregon to Clark County from 1998 to 2000, but 2,500 have moved from Clark County to Oregon (Table 2).

Other Reasons to Move

Many, and likely most, of the tax payers with capital gains that move to Clark County do so for reasons other than avoiding the tax. America is a highly mobile country where people move for any number of reasons. Of the 101,000 Oregon households that moved in 2000, nearly 60 percent moved to a different county in Oregon.[4] Only 4 percent went to Clark County, Washington (Table 3).

For Oregonians moving to Clark County, Washington, housing affordability is likely to be an important reason behind their decision. Clark County has grown rapidly in recent decades by converting farmland into suburban housing developments. Offering lower housing prices, Clark County has attracted Portland residents. This, however, is true not just of Clark County, but also of the suburban counties surrounding the city of Portland. While 9 percent of households leaving Multnomah County went to Clark County, 40 percent went to either Washington County or Clackamas County. Movers from Clackamas and Washington counties are also far more likely to go to other Oregon counties, including Multnomah County, than to Clark County.

Another important non-tax-related reason for moving to Clark County is quality public education. As profiled in recent news stories, Portland-area families are moving to Clark County because of Oregon's demonstrated unwillingness to finance public education adequately.[5] Many parents believe that schools across the Columbia River are more likely to provide programs that have long since been cut in cash-strapped Oregon schools.

Table 3. Migration in Oregon and the Portland-area - 2000	Destination county			
County of origin	Clark County, WA	Multnomah County	Washington County	Clackamas County
All Oregon Counties	4%	12%	9%	8%
Multnomah County	9%		18%	21%
Washington County	5%	27%		13%
Clackamas County	5%	33%	16%	

Source: OCPP analysis of IRS migration data.

The median household income of those leaving Oregon for Clark County is very similar to households that choose not to move, suggesting that migration to Clark County does not represent an exodus of wealthy households fleeing Oregon taxes (Table 4). Households moving to Clark County from Multnomah County, for example, had a median income of $31,789, compared to a median income of $32,164 for households remaining in Multnomah County. Multnomah, Washington, and Clackamas counties account for more than 80 percent of all Oregon households moving to Clark County, Washington.[6]

Table 4. Median Household Income by Migration Status - 2000

County of origin	Non-migrant	Moving to Clark County
Multnomah County	$32,164	$31,789
Washington County	$40,932	$39,999
Clackamas County	$39,853	$38,181

Source: OCPP analysis of IRS county-to-county migration data.

Just 11 percent of Oregon households moving to Clark County had any capital gains income in 2000, less than the 19 percent of all Oregon full-year resident households that had capital gains income. Between 1993 and 2001 an average of 10 percent of households moving to Clark County had capital gains income, compared to 16.5 percent of full-year residents.

Compared to full-year residents, households moving to Clark County were less likely to have any capital gains income, but the average capital gains income was higher among migrants to Clark County. This, combined with the fact that the average capital gains income of those moving to Clark County was significantly higher than it had been in the previous year, prompted the Legislative Revenue Office, the Oregon Economic and Community Development Department, and the Oregon Department of Revenue ("the LRO-OECD-DOR Report") to conclude that tax avoidance could not be ruled out as a motivating factor for some households moving to Clark County.[7]

The higher than average capital gains among those moving to Clark County, however, is partly explained by the fact that most Oregon households moving to Clark County are from counties with higher than average incomes. In 1999-2000, full-year residents of Multnomah, Washington, and Clackamas counties had 57 percent higher average capital gains income than residents of all other Oregon counties.[8] The very small number of households with capital gains moving to Clark County, makes it possible that only a few households with large capital gains realizations are skewing the average gains.

In addition, while average gains rose for those moving to Clark County, they also increased among Oregon's full-year residents. From 1995 to 2000, the average capital gains income among full-year residents increased 13 percent each year, on average.

Much of the higher than average capital gains of households moving to Clark County is due to factors other than tax avoidance. In fact, the average capital gains of residents moving to Clark County in 2001 was over $100,000 in their final year of full-time residence in Oregon and $31,535 after they moved to Washington. If tax avoidance is an important motivator of migration decisions, then these households strangely waited to leave Oregon until after they realized large gains, opting to pay more in taxes. More realistic is that tax avoidance plays a very minor, if any, role in shaping migration decisions.

The LRO-OECD-DOR Report concluded that a capital gains tax incentive program enacted in 1995 did nothing to reduce migration to Clark County. Deemed a failure, the program was phased out in 1999.

Capital gains taxes and migration have little impact on investment and jobs

The number of taxpayers with capital gains leaving Oregon for Clark County, Washington is quite small, suggesting little impact on investment in Oregon. Even if some taxpayers leave Oregon to avoid the tax, there is little reason to expect that they would take their investment out of Oregon.

The LRO-OECD-DOR Report concluded:

> "The movement of Oregon residents to Clark County, Washington, even if it is to avoid Oregon's income tax on capital gains, does not necessarily lead to less investment in Oregon. Once a taxpayer establishes residence in Washington, capital gains income for that taxpayer is not subject to Oregon's income tax if the investment is structured properly… Once they establish residence in Washington, they can continue to invest in Oregon and have capital gains free of Oregon's income taxation."[9]

Since most sales of capital gains assets are related to stocks in companies outside of Oregon, movement to Clark County, even if it is to avoid taxes, has little or no impact on jobs in Oregon. Even the sale of companies located in Oregon does not necessarily impact jobs in Oregon. Sale by the previous owner implies that someone else bought the company. The new owners will most likely keep a recently purchased company, and its employees, in Oregon.

A review of Oregon's economic record over the last decade also gives little reason to think that the tax on capital gains income has had any impact on economic growth in Oregon. Between 1995 and 2000, Oregon's economy grew faster than any other state, based on per-capita Gross State Product.[10] As recently as 2000, Oregon had the third fastest growing state economy in the country. Between 1989 and 2000, 30,000 new businesses and 415,000 jobs were created in Oregon. During those years Oregon's population expanded by 650,000 (23 percent), largely due to people moving to Oregon. In its 2002 *State Technology and Science Index*, the Milken Institute ranked Oregon among the top 10 states for new businesses.[11] Given that Oregon saw the 11th fastest population growth in the country over the 1990s, the concern that capital gains taxes prevent people from moving to or staying in Oregon is misplaced, at best.

During this period of rapid growth, Oregon's capital gains tax rate was 9 percent, the current rate. Oregon's economy grew faster than states with lower capital gains tax rates and those with no capital gains tax.

Capital Gains Taxed Under the Current System

In addition to the small number of households with capital gains moving to Clark County, Washington, the high levels of capital gains income realized in Oregon in recent years suggests that the current tax is not a very powerful

Table 5.	Capital Gains Income in Oregon – 2000
Full-year tax returns with capital gains income	271,317
% of total returns	19%
Total Capital Gains Income	$6.1 billion
Source: OCPP analysis of ODR Income Tax Statistics.	

incentive for people to leave the state. Out of 1.4 million full-year tax returns filed in 2000, over 271,000 (almost 19 percent) reported some capital gains income (Table 5).[12] Total capital gains income reported was more than $6.1 billion.

The most affluent one percent of households alone reported $3.5 billion in capital gains income in 2000. These highest-income 14,000 households reported an average of $243,000 in capital gains income (Table 6). The top 0.4 percent of households (the 5,600 households with adjusted gross incomes above $500,000) averaged $524,000 in capital gains income. These affluent households clearly have the means to relocate outside of Oregon if the capital gains tax were really as burdensome as claimed by tax cut advocates. That so many wealthy households choose to remain in Oregon speaks volumes about how little this tax impacts relocation decisions. Capital gains income is considerably more concentrated at the top than most sources of income. The top one percent had 57 percent of all capital gains income, but just 17 percent of all income. The richest 5 percent have 74 percent of capital gains income, and 31 percent of all income. The lowest-income 80 percent of Oregon households had 13 percent of all capital gains income, but 42 percent of all income. The bottom 80 percent of households averaged $690 in capital gains income in 2000.

More than 80 percent of Oregon households had no capital gains income whatsoever. While more than 70 percent of the richest one percent of households had capital gains income in 2000, just 14 percent of those in the bottom 80 percent of households had any capital gains. Most of those with any capital gains income had very little. *Among those with capital gains income*, the richest one percent of households averaged $339,000, while the bottom 80 percent averaged just $5,110.

Capital gains constitute 32 percent of the income of the richest one percent of households, but only 3 percent of the income of the bottom 80 percent of households.

Changes would have significant costs.

High levels of capital gains realizations in Oregon and particularly the large

Table 6. Distribution of Capital Gains - by Income Level - 2000

Oregon Households by Income Level	Average Capital Gains Income	Cap Gains as % of AGI	Share with any Capital Gains Income	*Average Capital Gain Among Those with Any Gains	Share of capital gains	Share of total income
Top 0.4%	$523,723	37%	77%	$684,576	48%	12%
Top 1 %	$242,814	32%	72%	$339,357	57%	17%
Top 5%	$63,331	11%	60%	$106,000	74%	31%
Bottom 80%	$692	3%	14%	$5,110	13%	42%

*Only households with positive capital gains income

Source: OCPP analysis of ODR data.

gains among very high-income households, suggest the current tax provides little incentive for people to move. The price tag for reducing the tax on capital gains income, however, is considerable. In 2000, capital gains income yielded $425 million in income taxes in Oregon.[13] Although capital gains realizations have temporarily declined with the slumping stock market, they are expected to recover in the near future. The Legislative Revenue Office recently projected that reducing the tax on capital gains income from 9 percent to 4 percent would cost Oregon $319 million in the 2005-07 budget cycle.[14] To put that in perspective, $319 million is more than the general fund budgets of all natural resources, economic and community development, transportation, consumer and business services agencies and legislative branch, combined.[15]

Conclusion

While proponents of reducing or eliminating the income tax on capital gains make claims that the tax results in lost revenues and lost Oregon investments, tax return data, and common sense, show their arguments are bankrupt. Anecdotal evidence of a flood of persons leaving Oregon for Washington to avoid Oregon's income tax on capital gains misrepresents reality. It is, at best, a trickle and not cause for changing Oregon's income tax on capital gains.

Jeff Thompson is a policy analyst at the Oregon Center for Public Policy. His previous work has focused on the economy, taxes, and labor issues.

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Endnotes

[1] A family who lives in Washington but works exclusively in Oregon will pay income tax on money earned in Oregon; in this case, money from their job(s). However, capital gains and other forms of unearned income such as interest and dividends, are considered earned in the state of residence. Thus Washington, which does not have an income tax, does not tax capital gains and the family pays no state capital gains tax.

[2] Total capital gains income of households leaving Oregon for any US location averaged 3.2 percent of the total capital gains of Oregon full-year residents between 1993 and 2001.

[3] Migration and population data from the Oregon Economic and Revenue Forecast, March 2003, Office of Economic Analysis.

[4] Data for migration inside the U.S. OCPP analysis of IRS county-to-county migration data.

[5] Graves, Bill, "Families Flee to Schools in Southwest Washington," *The Oregonian*, February 23, 2003.

[6] OCPP analysis of IRS migration data.

[7] *Oregon's Capital Gains Deferral Program: An Evaluation of the First Two Years*, Oregon Department of Revenue, Legislative Revenue Office, and Oregon Economic Development Department, March 30, 1999.

[8] OCPP analysis of Oregon Department of Revenue Income Tax Statistics from 1999 and 2000. Full-year residents of Multnomah, Clackamas, and Washington counties had average capital gains income of $2,600, compared to $1,650 for full-year residents of all other Oregon counties.

[9] *Oregon's Capital Gains Deferral Program: An Evaluation of the First Two Years*, March 30, 1999, page 8.

[10] OCPP analysis of BEA data.

[11] Devol, Ross, *State Technology and Science Index*, Milken Institue, September 2002, page 78. The ranking is for business starts per 100,000 people and is based on 1999 data. Oregon is ranked 8th among states by this measure.

[12] Returns with capital losses are not included.

[13] Personal communication with OEA economist, Michael Kennedy, January 6, 2003.

[14] Personal communication with LRO economist Lizbeth Mahar, February 12, 2003.

[15] Governor Kulongoski's proposed 2003-05 budget allocates $142 million in General Fund revenues to all Natural Resource programs, $12 million to Transportation programs, $27 million to Economic and Community Development programs, $11.7 million to Consumer and Business Services programs, and $74 million for the Legislative Branch. Combined, these programs are allocated $267 million in General Fund revenues in 2003-05. The 2003-05 allocation is equivalent, after adjusting for projected growth in population and inflation, to $291 million in 2005-07.

Appendix A. Capital Gains and Migration to Clark County

	Total Full-Year Returns	Full-year Returns with Capital Gains Income	% of all Full-Year Returns	Taxpayers with Capital Gains Income Moving to Clark County, WA During the Tax Year	% of all Full-Year Returns	% of Full-Year Returns with Capital Gains
1993	1,235,970	158,955	12.9%	251	0.02%	0.16%
1994	1,267,485	188,418	14.9%	249	0.02%	0.13%
1995	1,302,656	202,940	15.6%	274	0.02%	0.14%
1996	1,345,533	229,920	17.1%	438	0.03%	0.19%
1997	1,381,479	254,140	18.4%	408	0.03%	0.16%
1998	1,403,128	261,910	18.7%	426	0.03%	0.16%
1999	1,414,966	274,441	19.4%	433	0.03%	0.16%
2000	1,435,203	271,317	18.9%	459	0.03%	0.17%
2001*	1,434,684	189,430	13.2%	279	0.02%	0.15%
1993 - 2001 Average	1,357,900	225,719	16.6%	357	0.03%	0.16%

*Based on preliminary 2001 personal income tax data.

Source: OCPP analysis of ODR data.